Supreme Court, U.S.
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In the Supreme Court of the United States

OCTOBER TERM, 1971.

No. 70-79.

RELIANCE ELECTRIC COMPANY,
Petitioner,

v.

EMERSON ELECTRIC COMPANY,
Respondent.

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT.

REPLY BRIEF FOR PETITIONER.

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ARGUMENT.

I. THE QUESTION PRESENTED IS WHETHER EMERSON'S TWO-STEP SALE PROCEDURE IS TO BE APPROVED AS A METHOD FOR AVOIDING SECTION 16(b) LIABILITY.

The central issue in the instant case requires a careful distinction between the following two situations:

Case I: A 10% beneficial owner, while enjoying insider status, determines to dispose of shares of the issuer, acquired when he was a 10% beneficial owner, at a profit, and carries out this decision by selling those shares within less than six months of their purchase. Section 16(b) clearly requires that such profit inure to the issuer. The particular technique

of disposition used to carry out the decision to dispose of the shares should not affect this result.

Case II: A former 10% beneficial owner, after he has ceased enjoying insider status, determines to dispose of shares of the issuer, acquired when he was a 10% beneficial owner, at a profit, and carries out this decision by selling those shares within less than six months of their purchase. Whether Section 16(b) requires that such profit inure to the issuer is arguable; the SEC maintains that it should, and Emerson maintains that it should not. The particular technique of disposition used to carry out the decision to dispose of the shares is in the view of neither the SEC nor Emerson a significant factor.

The reason why the applicability of Section 16(b) is arguable in Case II, but certain in Case I, is that the 10% beneficial owner in Case II has assumed some period of investment risk as an outsider, and, as his decision to sell was formulated after he relinquished insider status, it cannot be presumed that the consequent sale was based upon inside information or made by reason of the shareholder's relationship to the issuer. In Case I, however, the 10% beneficial owner has decided not to assume for any significant period the investment risk of an outsider, and has made his decision to sell at a time when Section 16(b) irrebuttably presumes the availability and use of inside information. A decision by the 10% beneficial owner in Case I, made while an insider, to dispose of stock in two sale transactions is indistinguishable, in its potential for unfair use of inside information, from a decision made at such time to dispose of the same stock in one sale transaction, to which Section 16(b) clearly applies.

The facts in the case at bar correspond to those in Case I, not to those in Case II. In its brief, however, Emerson asserts that the instant case is Case II, and Emerson's major arguments are directed toward the question of how Section 16(b) applies to Case II. To make such an argument, Emerson's brief makes factual assertions directly contrary to the facts as found by the District Court below and as accepted by the Eighth Circuit Court of Appeals. A parallel comparison shows how Emerson has departed, in crucial respects from the facts in this case:

Emerson's Assertions	The District Court's Findings
"There is no dispute that the first sale was made because Emerson feared that the forthcoming Reliance-Dodge merger, which it had opposed, would result in an *involuntary* "sale" of Emerson's stock within the meaning of § 16 (b)." (Emerson Br. p. 22; emphasis Emerson's.)	"Emerson's initial sale of 37,000 shares was motivated *solely* by its desire to reduce its holding to just under 10% immediately prior to disposing of the balance of its shares in an attempt to escape Section 16(b) liability on the short-swing profits it contemplated would be made upon such remaining shares." (A. 163; emphasis added.)
"The second sale, *i.e.*, the sale to Dodge, was *concededly not anticipated* at the time of the first sale, and was initiated by Reliance, not Emerson." (Emerson Br. p. 22; emphasis Emerson's.)	"That the negotiations with Reliance for the sale of the Emerson-held Dodge shares were initiated by Reliance does not affect our conclusion that the two sales were in fact interrelated parts of a single plan. In fact, in his June 26 letter, Emerson's counsel *had anticipated* the possibility of a settlement under a negotiated agreement providing for the purchase of the Dodge shares owned by Emerson . . . ." (A. 164; emphasis added.)

Emerson's Assertions	The Eighth Circuit's View
"There is no indication that Emerson, when its first sale of Dodge stock was completed, had any plan whatsoever—let alone a 'binding commitment' —to sell its remaining Dodge stock to anyone." (Emerson Br. p. 40.)[1]	"The District Court found that while Emerson was the beneficial owner of 13.2 percent of Dodge shares it determined to dispose of *its entire stock holdings pursuant to a plan* whereby it hoped to avoid, to the extent possible, Section 16(b) liability for short term profits. *Pursuant to that determination* it made the mentioned two separate sales not tied in any legal way to each other." (A. 180; emphasis added.)

Emerson's attempt to change the facts from the Case I pattern to the Case II pattern appears in its brief not only in the portions quoted above, but throughout. Thus, Emerson has restated the "Question Presented" to present the Case II problem; and assertions of fact substantially equivalent to those quoted above appear on pages 8, 32 and 37. Emerson's version of the facts underlies much of its legal argument, for none of the authorities discussed by Emerson at pages 13-16 discuss the application of Section 16(b) to a "single pre-determined plan of disposition" (A. 163) formulated by a 10% beneficial owner when an insider and carried out through the technique of two sales. Similarly, the application of Section 16(a) to the two-step

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[1] Emerson's statement to the Eighth Circuit below belies its assertion here:

> "Thereupon, with the Dodge-Reliance merger upcoming, *Emerson concluded* that, rather than remain a stockholder of Dodge and accept the securities of Reliance pursuant to the Dodge-Reliance merger, *it would undertake to dispose of its 152,282 shares* of Dodge stock in two separate and distinct transactions—first a sale of 37,000 shares, reducing its holdings to less than 10%, and second a sale of the balance." (A. 168; emphasis added.)

sale procedure has not been determined, and Emerson's argument at pages 17-18 bears only on the Case II pattern. Emerson's refusal to address its arguments to the "two-step sale procedure" (the District Court's phrase, A. 164) or to the Case I factual pattern presented by the record accurately reflects, we submit, the paucity of arguments available to support the decision of the Eighth Circuit on this point.

II. THE TERMS "SALE" AND "AT THE TIME OF SALE" AS USED IN SECTION 16(b) SHOULD BE CONSTRUED WITH A VIEW TO THE PURPOSE OF SECTION 16(b).

Emerson's argument, and the decision of the Eighth Circuit, both rely in large part on the assertion that Emerson made "two independent sales." There is a semantic problem here, arising from the confusion of two bodies of law. The term "sale" is a term of contract law and commercial law. A determination whether a given factual pattern presents one sale or two sales is made by counting the number of occasions of passage of title. *Cf.* Uniform Commercial Code, Section 2-106(1). From the view of commercial law, Emerson made two "sales," and its two sales were, as a matter of commercial law, separate and independent.[2]

The unspoken assumption of Emerson's argument, and that of the Eighth Circuit, is that the commercial law

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[2] Because the sales were valid commercial transactions, neither was a "sham." In the same sense, the exchange of Micro-Moisture stock for Converters' assets in *SEC v. Micro-Moisture Controls, Inc.*, 148 F. Supp. 558 (S.D.N.Y. 1957), *affirmed sub nom. SEC v. Culpepper*, 270 F.2d 241 (2d Cir. 1959), was presumably a valid corporate transaction; the court does not suggest otherwise. The failure to register the stock so issued in no sense rendered the issuance a "sham." Neither the step transaction doctrine nor the substance over form principle is limited to cases of sham or fraud, as Emerson asserts. See Brief for Petitioner, pp. 24-27.

concept of "sale" is determinative. If this were so, most of the cases which have arisen under Section 16(b) since its enactment would have been wrongly decided, since by far the most frequently arising question under Section 16(b) has been the interpretation of the words "purchase" and "sale" in the light of the statutory purpose of Section 16(b). See cases cited in Brief for Petitioner, pp. 19-22; Meeker & Cooney, "The Problem of Definition in Determining Insider Liabilities Under Section 16(b)," 45 *Va. L. Rev.* 949, 958 *ff.* (1959).

The recent decision in *Abrams v. Occidental Petroleum Corp.*, Docket Nos. 71-1273-76, 2d Cir., October 13, 1971, reversing the District Court decision cited in both briefs and reported at 323 F. Supp. 570 (S.D.N.Y. 1971), illustrates the uniform standard of construction applied by courts. As Chief Judge Friendly makes clear, the determination whether a given transaction constitutes a "purchase" or "sale" depends on whether the transaction "could have lent itself to speculative abuse." Slip Opinion, p. 75. The Second Circuit held that the merger of Kern County Land Co. into a subsidiary of Tenneco Corp. did not constitute a "sale" of Occidental's Kern County shares, because the possibility of speculative abuse was not present;[3] and that the option granted by Occidental to Tenneco did not constitute a "sale" under Section 16(b).

Reliance is thus not seeking an extension of Section 16(b), or a "remedial" construction of the statute at variance with the standards of construction always held

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[3] Under the Second Circuit's decision in *Occidental*, the exchange of Emerson's Dodge shares for Reliance shares in the Dodge-Reliance merger would probably not have constituted a "sale" for Section 16(b) purposes. As Emerson did not hold its Dodge shares until the merger closed, but instead sold them for cash, the *Occidental* decision is of no help to Emerson.

applicable under Section 16(b). Reliance simply asks for application of the general rule that the words "sale" and "at the time of sale," whatever they may mean in other contexts, be here construed in the context of the statutory purpose of Section 16(b). *Cf. SEC v. National Securities, Inc.*, 393 U.S. 453, 466-67 (1969). In the light of Section 16(b), it simply cannot be said that Emerson made "*two totally independent sales.*" (Emerson Br. p. 23; emphasis Emerson's.) The facts as found by the District Court show unquestionably that the two sales were united in intent and purpose as "interrelated parts of a single plan." (A. 164.)

Whether Emerson's two sales are held to be subject to Section 16(b) by treating them as one "sale" as the term is used in Section 16(b), or whether the same result is reached by construing the phrase "at the time of sale" to include the entire period during which the series of related transactions took place, as the District Court did, is a matter of choice for this Court. We point out, however, that even Emerson appears to recede from its argument that the statutory terms are unambiguous in the latter respect, for while it argues that the words "at the time of sale" are unambiguous, it concedes that the words "at the time of purchase" are "arguably ambiguous" and were regarded as ambiguous by the Court of Appeals. Emerson Br. pp. 27, 30.

III. EMERSON'S DISPOSITION OF DODGE STOCK THROUGH THE TWO-STEP SALE PROCEDURE LENT ITSELF TO THE SPECULATION ENCOMPASSED BY SECTION 16(b).

At pages 31-33 of its brief, Emerson attempts to argue that it was not in fact privy to inside information as a shareholder of Dodge. At pages 33-35 Emerson seeks to dismiss the question whether the factual pattern of Emerson's transactions created the possibility of abuse of Section 16(b) as a "parade of horribles hypothesized." The law is to the contrary.

Whether Emerson actually used inside information, or whether inside information was available to Emerson, is entirely irrelevant to the applicability of Section 16(b).[4] *Smolowe v. Delendo Corp.*, 136 F.2d 231, 235-36 (2d Cir.), *cert. denied*, 320 U.S. 751 (1943); *Ferraiolo v. Newman*, 259 F.2d 342, 344 (6th Cir. 1958), *cert. denied*, 359 U.S. 927 (1959). The question which Section 16(b) requires a court to ask is whether, if inside information had been available, the transactions in question would have been apt vehicles for taking short-term profits on that information. It is obvious that, if Emerson had obtained inside information from Dodge immediately prior to its decision to dispose of its 152,282 shares of Dodge, possession of that information would have given Emerson precisely the kind of unfair advantage over other Dodge shareholders and the investing public which Section 16(b) was designed to prevent, and that both of Emerson's sales constituted apt vehicles for profiting on the inside information which the statute presumes was present.

Even if Emerson's protestations of innocence were

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[4] Equally irrelevant are the prior opinions and beliefs of Reliance and its counsel, and the fact that Reliance participated in Emerson's sale to Dodge. *Magida v. Continental Can Co.*, 231 F.2d 843, 846-47 (2d Cir.), *cert. denied*, 351 U.S. 972 (1956).

relevant, which they are not, they are not borne out by the record. As the Eighth Circuit observed: "An insider engaged in a contest for control of its stock issuer may have substantial opportunity for short-term profits perforce of its substantial stock ownership." (A. 179.) Consider Emerson's dealings. Just *prior* to its purchase on June 16, 1967, Emerson's board authorized an agreement of merger with Dodge. This offer to merge was first revealed to Dodge on June 17, the day after Emerson purchased 152,282 Dodge shares at $63 per share, and first revealed to the general public the following Monday. (Plaintiff's Exhibits 16 and 17, A. 104-07.) Emerson maintained the credibility of its merger offer by engaging in litigation and in a vigorous proxy contest with Reliance. (Plaintiff's Exhibits 24-31, A. 125-54.) Throughout the contest, Emerson attempted to convince the Dodge shareholders that its merger offer was worth substantially more to them than $63 per share. ($74.25 and $81.56 were the per-share values claimed by Emerson in Plaintiff's Exhibits 27 and 30, A. 132, A. 151.) Emerson must have known that its merger offer would have an effect on the market for Dodge shares which would create and maintain a substantial opportunity for short-term profits for Emerson. When Emerson learned that the Reliance merger had been approved by the Dodge shareholders, Emerson decided to withdraw from the contest for control of Dodge. Since Emerson's merger offer would thereafter no longer exert a significant upward pressure on the market price of Dodge stock, Emerson determined to take its partially self-generated short-term profit by promptly disposing of all its Dodge stock. Emerson did so, and took its profit. Reliance submits that it would be contrary to the spirit as well as to the letter of Section 16(b) to permit Emerson to retain such profit.

CONCLUSION.

For the reasons stated above and in the Brief for Petitioner, the Court should reverse the judgment of the Eighth Circuit Court of Appeals on Emerson's second sale.

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